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TAGS: [EFIN](#) [ECON](#) [TU](#)  
SUBJECT: TURKEY: IMF DEAL REQUIRES POLITICAL DECISION

REF: A. ANKARA 122  
[1](#)B. ANKARA 85  
[1](#)C. ANKARA 68

Classified By: Econ Counselor Dale Eppler for reasons 1.4(b,d)

[1](#)1. (C) Summary: When the GOT and IMF suspended negotiations on January 26, they were apart on key issues such as the type and quality of spending cuts, the terms of a fiscal rule, reduction of disbursements to municipalities, and the need to beef up taxation and enforcement. While the GOT has said publicly that the break is for 10 days, Treasury Minister Simsek has privately told the Fund that it should not send a Mission back to Turkey until they are ready to conclude an agreement. IMF Deputy Resident Rep Lombardo said the GOT has to make a political decision on what it is willing to commit to, and put those commitments in the letter of intent with measurable performance goals. He thought a letter of intent could be signed before March elections. The two sides are "in the ballpark" on the amount of adjustment needed and the size of an agreement. There still is no firm agreement on how funds would be passed through to the real sector, with doubts about whether the credit channel is open. End summary.

[1](#)2. (SBU) The GOT and IMF announced January 26 that they were temporarily suspending talks after nearly three weeks of negotiations. The GOT said publicly there would be 10-day break in talks, while both sides reviewed and discussed structural issues and possible changes to fiscal policy. On January 28, Prime Minister Erdogan and Treasury Minister Simsek traveled to the World Economic Forum in Davos, Switzerland and held two lengthy meetings with IMF Deputy Managing Director John Lipsky (reportedly, the meetings began at midnight and ran until 3 AM). Press reports quoted the Prime Minister afterwards as saying he liked Lipsky's approach and hoped an agreement would be reached, but also it would not be "the end of the world" if Turkey did not sign a deal with the IMF. Markets have taken this break in stride, amid widespread expectation that a deal ultimately will be signed. Analyst opinion is mainly divided over whether the deal would be concluded before or after March 29 municipal elections.

What,s Still on the Table?  
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[1](#)3. (C) Prior to the January 26 suspension, our understanding was that the talks were bogged down over several key issues:

-- The Quality of Spending Cuts -- Against the IMF,s express request, the GOT had made cuts almost exclusively in investment spending, and had indicated that it would cut investment spending further if the Fund demanded additional spending cuts. The Fund wanted the GOT to reverse those

investment cuts (arguing they only postpone needed investments and don't fix institutionalized overspending) and instead wanted cuts in spending that the GOT said were politically unacceptable, e.g., capping civil service wage increases, reducing municipal spending, and taxing pension income of retirees under age 60.

-- Medium term fiscal controls -- After the GOT released its 2008 budget performance report, showing that Turkey had missed its primary fiscal target for the third year in a row, the IMF had begun to stiffen its position on reforms needed to improve Turkey's fiscal performance in the medium term, such as reforming tax administration, increasing auditing, and cracking down on informal employment. The Fund wanted a very credible program to convince investors that the targets were real. The GOT objected to being penalized for actions under the prior Stand-By Agreement, and Turkish Treasury had not been able to get agreement from the Finance Ministry on tax administration reforms.

-- Designing the Fiscal Rule -- One key component of the medium term fiscal plan is creating a binding fiscal rule for Turkey. The IMF hosted a workshop in December with international experts who spoke about how fiscal rules work in other countries, but the GOT had not yet made a proposal for a Turkish fiscal rule, and had not yet decided on touchy design elements such as enforceability and whether to create an independent agency.

-- How to get IMF funds to the private sector -- both sides agreed that the Turkish corporate sector will need access to foreign exchange for debt payments in 2009. But there are doubts on both sides whether the banking sector can act as the conduit, because they are reluctant to lend in current economic conditions.

14. (C) Davide Lombardo, IMF Deputy Resident Representative, told Econoff January 30 that it "was not and is not" his impression that the GOT is delaying a deal until after the March 29 municipal elections. However, the GOT must make a political decision on what it is willing to commit to, and those commitments must be outlined with measurable goals in the letter of intent. Lombardo said that it is increasingly clear that 2009 will be a difficult year and that GOT debt levels will increase. The IMF wants to see structural reforms and fiscal adjustments for the short to medium term that will convince investors that 2009 is a short-term hiccup and not the beginning of a reversal of Turkey's commitment to fiscal responsibility and reform. The IMF and GOT appear to be apart on the terms of a fiscal rule, reduction of disbursements to municipalities, and the need to beef up taxation and enforcement. They are "in the ballpark" on the amount of adjustment needed and the size of a deal. The Fund believes any new agreement must last at least two budget cycles, to allow the GOT time to show improvements and ensure that debt reduction continues.

15. (C) There still was no firm agreement on how funds would be passed through to the real sector. Lombardo said the preferred GOT mechanism would be to give the money to the Treasury Ministry, which would deposit it in the Central Bank and use it to make debt payments. Theoretically, this would reduce GOT borrowing and free up foreign exchange held by banks for use by the corporate sector to make debt payments and fund operations. But there are still doubts about the willingness of banks to lend in the current grim economic environment. If this credit channel is blocked in whole or part, both sides have to consider how else to get money to the businesses that need it. (Note: In conversations with banks, banking regulators, and business people, we hear disparate views on the current willingness of banks to make business loans. End note.)

16. (C) Lombardo said that the IMF Mission is willing to return in February with additional structural experts. However, Treasury Minister Simsek had privately made clear that the Mission should not return until they are ready to close an agreement. Simsek wants both sides to make progress

"remotely" before another trip is planned.

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